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**Review of the Effectiveness of the System of Internal Audit 2014-15**

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**Report of the Director of Finance**

**1. Purpose of Report**

- 1.1. This report presents the findings of the annual review of the effectiveness of the Council's system of internal audit for 2014-15.

**2. Recommendations**

- 2.1. The Committee is recommended to:
- a) Accept the findings of this review, and
  - b) Conclude that the Council has an effective system of internal audit upon which it (the Council) can place reliance.

**3. Summary**

- 3.1. Leicester City Council's Finance Division includes Internal Audit which carries out reviews of financial and management systems and seeks to provide assurance to management on the effectiveness of their management controls. Recommendations are made to improve systems and procedures, as appropriate, with the aim being to reduce the Council's exposure to unacceptable levels of risk.
- 3.2. As such, Internal Audit is an integral part of the Council's overall system of internal control, which is the means by which the Council ensures its resources are used effectively and for their intended purpose.
- 3.3. Another fundamental component of the Council's system of internal audit is the Audit and Risk Committee. The Committee has an essential role to play in providing independent assurance on the effectiveness of the Council's system of internal control as a contribution to the Council's governance arrangements as reported in the Annual Governance Statement. The process for this was outlined in a report on the Council's Assurance Framework and the Annual Review of the Committee's Terms of Reference, the latest annual review of which was approved by the Committee at its meeting on 31 March 2015.

- 3.4. The Accounts and Audit Regulations 2015 requires that the Council, in its capacity as a relevant authority:
- *‘must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance.,*
- and,
- *‘...must conduct a review of the effectiveness of the system of internal control.’*
- 3.5. This review is part of a wider annual review of that system of internal control following which a report is to be submitted to this Committee and the outcome included in the Council’s Annual Governance Statement. The purpose is to give the Council assurance that reliance can be placed upon the overall system of internal audit including the work of both Internal Audit and the Audit and Risk Committee.
- 3.6. This is the last time this report will be produced in this format, following the issue of the Accounts and Audit Regulations 2015. These updated regulations remove the previous requirement that the Council *‘must, at least once in each year, conduct a review of the effectiveness of its internal audit’* and report the outcome to the Audit & Risk Committee. For the Financial Year 2015-16 this requirement has gone. It is our assumption that, as the new Regulations refer almost directly to the Public Sector Internal Audit Standards (PSIAS), which require annual assessment of conformance and make much of the responsibilities of ‘the Board’ (the A&R Committee in our case), that our report confirming compliance with PSIAS will act as the annual review of effectiveness of Internal Audit in future years.

#### **4. Report**

- 4.1. In 2009, the Chartered Institute of Public Finance and Accountancy CIPFA issued their ‘Guidance Note on the Review of the Effectiveness of the System of Internal Audit’, defining this system as:
- ‘The framework of assurance available to satisfy a local authority that the risks to its objectives, and the risks inherent in undertaking its work, have been properly identified and are being managed by controls that are adequately designed and effective in operation.’*
- 4.2. In practice, this comprises:
- The organisation’s risk management strategy and policy
  - The process of coverage of key controls and key assurance providers, both internal and external
  - The adequacy and effectiveness of remedial action taken where defects in control have been identified
  - The operation of the Audit and Risk Committee and Internal Audit in accordance with current codes and standards.
- 4.3. This review of the system of Internal Audit uses the above definition. The results of the review are set out below in Appendix 1.

4.4. In my opinion, the Council has an effective system of internal audit. The key conclusions from the review are:

- The Council's Risk Management Policy and Strategy have been reviewed, updated and approved by the Corporate Management Team (formerly this was done by the Strategic Management Board) and the Executive and was noted by the Audit and Risk Committee. Work continues to ensure that both strategic and operational risk registers are complete and topical as part of the Strategy. As part of the 2015 Strategy, work continues to ensure that risk management becomes truly embedded within the council at all levels. The progress of this work is reported to each meeting of this Committee in the Risk Management and Insurance Services update.
- The Risk Management Strategy and Policy was a key element in the Head of Internal Audit and Risk Management's success in becoming the 'ALARM – the Public Sector Risk Management Association' Risk manager of the Year for 2014/15. This culminated in presentations being delivered in June 2015 to international risk managers in Texas as part of the PRIMA International Conference and to UK members of ALARM in Birmingham. This presentation, which outlines the success here at Leicester in implementing an ISO31000 and ERM (Enterprise Risk Management) compliant risk management process, is also being delivered to ALARM – Scotland in October and PRIMA have asked if this can be delivered for them again next year, again in the USA.
- Internal Audit has maintained actions taken to implement recommendations made by the Audit Commission in their last independent review of the service, and Internal Audit work continues to be relied on by the External Auditors (currently KPMG) in relevant aspects of their work. Internal Audit plan to carry out a self-assessment of the service against the Public Sector Internal Audit Standards, the result of which will be reported to this committee.
- The Internal Audit Plan reflects a risk-based approach consistent with the requirements of the 'Public Sector Internal Audit Standards'. Part of the (inter)national presentation mentioned earlier is the process by which Leicester have combined its risk and audit functions without damaging audit independence and allowing a traditionally, steadfastly 'third line' Internal Audit function to operate much more cohesively with the 'first and second lines' here at the Council (This represents the three lines of defence model of internal control and assurance, where the first line is management's own responsibility for control; the second line is the regulatory and advisory support functions (including Risk management amongst others); and the third line is Internal Audit – the independent review and assurance function).
- Customer satisfaction returns continue to indicate a high level of satisfaction (average 99%) with the audit team for individual pieces of work, though there continues to be a low level of response (only 5) and, with the move toward more third party audit work being delivered by the team, a reducing number of 'internal' clients.

- The team is endeavouring to improve both productivity and the time management of individual audit assignments further. They took part in CIPFA audit benchmarking for 2014 (although budget restrictions means that this is likely to be a bi or tri-annual event in future), as well as regional practitioner meetings with a view to keeping abreast of best practice.
  - The team remains adequately resourced, especially in view of the budget pressures facing the whole of the City Council. The team continues to provide the various technical disciplines within internal audit, such as the audit of IT as well as the more traditional emphasis on financial control and probity.
- 4.5. The Council's approach to counter-fraud work continues through the provision of a dedicated Corporate Investigations team, although this function is not part of Internal Audit and reports separately to the Head of Revenue and Customer Support. Regular liaison meetings take place between Corporate Investigations and Internal Audit, however, to ensure that matters of mutual interest are communicated to and understood by each service. As well as investigating a number of high-profile matters during the year, the team will deliver fraud awareness training to managers and staff. An annual update on the counter fraud activity is brought to this Committee by the Corporate Investigations Manager.
- 4.6. The Audit and Risk Committee meets all of the indicators of being an effective audit committee as set out by CIPFA in their 2005 publication *'Audit Committees: Practical Guidance for Local Authorities'* and as subsequently amended. The Committee's annual report to the Council (13 November 2014) concluded that:

*'...the Audit and Risk Committee made a significant contribution to the good governance of the City Council. Through its work, it has reinforced the Council's systems of internal control and internal audit and has given valuable support to the arrangements for corporate governance, legal compliance and the management of risk.'*

Whilst this was for 2013-14 the version for 2014-15 is currently being worked on, but is unlikely to conclude any differently.

- 4.7. Therefore, it is concluded that the City Council has an effective system of internal audit.

## **5. FINANCIAL, LEGAL AND OTHER IMPLICATIONS**

### **5.1. Financial Implications**

The audit system is a key component of the Council's financial management and corporate governance systems. (*Colin Sharpe, Head of Finance*).

### **5.2. Legal Implications**

The conduct of a review of the Council's internal audit process is a statutory requirement under the Accounts and Audit Regulations 2011. (*Kamal Adatia, City Barrister and Head of Standards*).

### 5.3. **Climate Change Implications**

This report does not contain any significant climate change implications and therefore should not have a detrimental effect on the Council's climate change targets. (*Duncan Bell, Senior Environmental Consultant*).

### 6. **Other Implications**

<b>Other implications</b>	<b>Yes/No</b>	<b>Paragraph referred</b>
Equal Opportunities	No	-
Policy	No	-
Sustainable and Environmental	No	-
Crime and Disorder	Yes	4.5 and Appendix 1 section 11
Human Rights Act	No	-
Elderly/People on low incomes	No	-
Corporate Parenting	No	-
Health Inequalities	No	-
Risk Management	Yes	The whole report concerns the internal audit process, a main purpose of which is to give assurance to Directors and this Committee that risks are being properly identified and managed appropriately by the business.

### 7. **Consultations**

- 7.1. Tony Edeson, Head of Internal Audit and Risk Management  
Caroline Jackson, Head of Revenues and Customer Support  
Stuart Limb, Corporate Investigations Manager  
Steve Jones, Internal Audit Manager

### 8. **Background Papers – Local Government Act 1972**

- 8.1. Files held in Internal Audit.

### 9. **Report Author/Officer to Contact**

Alison Greenhill, Director of Finance–37 4001  
Tony Edeson, Head of Internal Audit and Risk Management–37 1621.

## **Objectives of Review**

The review is designed to examine sources of evidence, and thereby determine whether or not the Council's system of internal audit is sufficiently effective for the Council to be able to place reliance on its assessment of the system of internal control.

### **1. Sources of Evidence**

1.1. The following information was used to assess the system of internal audit:

- Review of the Risk Management Strategy and Policy, along with progress made in implementing it;
- The Internal Audit plan(s), annual report of Internal Audit and other reports to the Audit and Risk Committee on the delivery of the Internal Audit Plan(s);
- An assessment of the effectiveness of reporting on audit work in providing assurance on actions taken to address control deficiencies;
- Reliance placed on Internal Audit's work where relevant by KPMG as the Council's external auditor;
- Self-assessment of compliance by Internal Audit with recognised professional standards;
- Analysis of Internal Audit client satisfaction returns;
- Key performance statistics produced by Internal Audit during the course of 2014-15;
- Comparative analysis of some statistical measures of the service with those of comparable local authorities (via CIPFA benchmarking – when we partake);
- Review of the Council's arrangements for preventing and detecting fraud and corruption;
- An assessment of the work of the Audit and Risk Committee against the best practice set out in the CIPFA publication *Audit Committees - Practical Guidance for Local Authorities*.

1.2. The remainder of this paper considers and assesses each of the sources of evidence in turn.

### **2. Risk Management Strategy**

2.1. The strategy and policy have been reviewed and updated. Following their earlier acceptance by the Executive (as in 2011, 2012, 2013 and 2014) these were brought to the Audit and Risk Committee at its meeting on 4 February 2015 seeking approval of the strategy and policy.

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- 2.2. The updated strategy sets out its objectives as follows:
- To provide Members and officers with risk management reports that give a comprehensive picture of the Council's risk profile;
  - To assist the Council and its partners to adopt a 'fit for purpose' methodology towards identification, evaluations and control of risks and to help ensure those risks are reduced to an acceptable level;
  - To ensure that transparent and robust systems are in place to track and report upon existing and emerging risks which potentially could cause loss or damage to the Council;
  - To help further integrate risk management into the culture and day-to-day working of the Council and ensure a cross-divisional/operational approach is applied;
  - To provide reliable information on which to base the annual governance assurance statement.
- 2.3. Whilst much progress has been achieved during the past five years since the introduction of the Risk Management Strategy and Policy, work still needs to continue to fully embed risk management within the Council. A degree of reassessment will be required to adapt prevailing processes to dovetail into and meet the new challenges that will arise from continuing organisational reorganisations with pressures on budgets continuing and the inevitable, continuing impact on services.
- 2.4. It was a source of great pride for the Council for its risk management process to be recognised by industry peers as 'one of the best' and that further recognition was gained internationally when the Head of Internal Audit and Risk Management was sponsored as ALARM's UK Ambassador at the PRIMA International conference in Texas. Leicester City Council is now becoming seen as the 'go to' authority for guidance and support on Risk Management and Business Continuity within the UK public sector.

### **3. Internal Audit Plan, Annual Report and reporting to the Audit and Risk Committee**

- 3.1. The annual Internal Audit Plan was prepared before the start of the 2014-15 financial year. Once again, the Council have adopted a process whereby we have a 'high level', generic plan outlining in broad terms the areas of coverage. It is supplemented with detailed quarterly plans focussing on the specific audits to be undertaken within these areas. This allows the work of the audit team to be directed toward those areas of highest risk as the Council's overall risk profile changes throughout the year. This is important as a means of establishing the extent to which internal audit reports can give assurance on the overall system of internal control.

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- 3.2. As audit resources are finite, the audit plans are significantly focused on the highest-risk activities, subject to other sources of review and assurance (such as external audit) and previous Internal Audit work and findings. Specialist areas of coverage, including contract audit and core financial systems, have been maintained. The Council's investment in specialist IT audit remains strong with an in-house IT technical specialist. This resource is in great demand amongst our peer group authorities.
- 3.3. The 2014-15 Annual Report of Internal Audit will be presented to this Committee at its meeting on 29 September 2015. Progress reports have been submitted to the Committee throughout the year. These reports identified audit work done and its outcomes, with specific reference to any matters of concern. Progress reports will be presented to meetings of the Committee on a regular basis.
- 3.4. The reporting of audit work in this way stimulates a greater degree of action by officers to address audit findings and this should, in time, promote an improved internal control environment. As well as discussion of matters referred to in Internal Audit's own reports, the Committee has received specific reports from service management on:
- Regulation of Investigatory Powers Act (RIPA) – (Committee 29 September 2014)
  - Corporate Procurement Rules/Plan – (Committees 29 September 2014 and 29 October 2014)
  - Markets Management of Risk relating to Cash Collection – (Committee 29 October 2014)
  - Council Cash Collection Procedures – (Committee 29 October 2014)
  - Public Health Plan – (Committee 3 December 2014)
  - Lync/Telephony/Customer Service Centre Issues – (Committee 4 February 2015)
  - Update on actions taken following the OFSTED Report – (Committee 1 July 2015)
- 3.5. Internal Audit remains on course to achieve its target level of completion of planned audits during the year – see also 8.2 below.



**4. The effectiveness of reporting on audit work in providing assurance on actions taken to address control deficiencies**

- 4.1. The reporting to the Audit and Risk Committee makes a significant contribution in this respect. These reports identify Internal Audit reports finalised in the period under review and present a high level summary of Internal Audit's conclusions including the overall trends in the level of assurance Internal Audit can give on the strength of controls in operation.
- 4.2. In addition, Internal Audit prepares an annual Summary of Internal Audit Conclusions, which is submitted after the end of each financial year to the Strategic Management Board and the Audit and Risk Committee. At the time of writing, the Summary for 2014-15 is scheduled to come to this Committee on 29 September. These reports have been produced for a number of years and have always been well received and there is nothing to indicate that this will not be the case for 2014-15.

**5. Reliance on Internal Audit by the External Auditor**

- 5.1. The Council's external auditors have periodically reviewed the Internal Audit function. During 2009 they carried out their last fully detailed review, which was reported to the Audit and Risk Committee at its meeting on 3 February 2010.
- 5.2. The auditor's assessment, at that time, concluded that Internal Audit fully or substantially met nine of the eleven CIPFA standards, and partially met the other two. No standards were assessed as not being met. An action plan to improve compliance further was prepared and recommended actions have been implemented where applicable.
- 5.3. There has not been a further external audit review of Internal Audit since 2009 and the Audit Commission, prior to its demise, had previously indicated that these reviews will no longer be undertaken. In future years, therefore, there will be a process of self-assessment against the CIPFA and the Public Sector Internal Audit standards. This has been done and a summary is given at paragraph 7 below. The Head of Internal Audit and Risk Management continues to seek other local Local Authorities to establish a network of 'peer group' reviews for future years.

**6. Internal Audit self-assessment of compliance with professional standards**

- 6.1. Internal Audit operates to the CIPFA *Code of Practice for Internal Audit in Local Government in the UK* and the Public Sector Internal Audit Standards. These are recognised as the professional standards for internal audit in all UK local authorities. They set out a number of standards, covering the scope of internal audit,

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independence, ethics, the audit committee, internal audit's relationships (such as with management and the external auditors), staffing and training, the audit strategy and planning, undertaking of audit work, due professional care, reporting and performance, quality and effectiveness. These are in turn assessed against many individual criteria and are now used as the basis of a self-assessment of the Council's internal audit team.

- 6.2. The outcomes of these self-assessment reviews are reported to the Audit and Risk Committee and an update on any actions arising from the reviews is given to the Committee as progress is made towards implementing those actions arising.

**7. Internal Audit Client Satisfaction Returns**

- 7.1. Another method of gauging clients' views of Internal Audit's work is analysis of the satisfaction survey returns issued at the end of each audit. These indicate satisfaction levels of over 90% in each of the last three years. However, there remains a low level of response from clients (returns in the mid-teens) which means that it is unsound to draw firm conclusions from this statistic. Having said that, it is likely that material dissatisfaction with the service would be made known in other ways and this has not been the case in the present (or past) year(s).

**8. Performance Measures and Statistics**

- 8.1. Internal Audit produces performance measures and statistics during the course of the year. The team continues its endeavours to maintain its performance in respect of delivering its annual plan, but struggles to maintain the extent to which individual audits have kept within their time budgets. One could argue that part of this is for reasons beyond Internal Audit's direct control but that does not alter the need to tighten up performance against this measure.
- 8.2. Within 2014/15 Internal Audit completed 84% of audits brought forward or commenced within the year. A further 12% were in progress at the year-end; the remaining 4% were to be started; most of these were awaiting the final go-ahead from the client.

**9. Comparative Analysis**

- 9.1. The Internal Audit section was a member of the CIPFA audit benchmarking club to allow comparison its performance with other local authorities. It is always difficult to draw conclusions from such exercises, although the latest findings appear to confirm that, when compared with other similar non-metropolitan unitary authorities the Internal Audit team fared well.
- 9.2. The CIPFA Audit Benchmarking Club endeavours to ensure that the comparisons are made on a like-with-like basis but there is always a

risk of differences in interpretation by those submitting data. However, the benchmarking returns are the best source of comparative data available and the financial pressures make comparisons of this kind increasingly important.

- 9.3. Financial restraints mean that this will cease to be an annual event, instead becoming a biennial or even triennial event in future.

#### **10. Review of the Council's arrangements for preventing and detecting fraud and corruption**

10.1. The Council has for many years had a specialist counter-fraud function. This had two main elements, a Corporate Counter-Fraud Team and a separate Revenues and Benefits Investigations Team. Between them, these teams conducted investigations into fraudulent activity of all kinds against the City Council.

10.2. The Corporate Counter-Fraud Team was, until September 2012, part of Internal Audit. However, when the Internal Audit shared service with the County Council was proposed, this team moved and now reports to the Head of Revenues and Customer Support. Following a further review in 2014, these two previously separate functions have been restructured ahead of the transfer of the benefit fraud team to the Department of Work and Pensions (DWP) in March 2016.

10.3. The Revenues and Benefits Investigations Team continues to provide a specialist investigation service for Housing benefit and Council Tax Reduction, working under regulations applicable to the Housing Benefits service. The Corporate Investigations Team investigate all non-benefit related financial irregularities and this team continue to be engaged by the Insurance team to help investigate (and prosecute) insurance fraudsters.

10.4. The Council has an Anti-Fraud, Bribery and Corruption Policy and Strategy, which is reviewed and updated when necessary. The latest revision was approved by the Audit and Risk Committee at its meeting on 1 July 2015.

10.5. The work of the Corporate Investigation Team is regularly reported to the Audit and Risk Committee, usually at its July and December meetings. The overall context remains a zero-tolerance approach to fraud against the Council, with a determination to prevent and detect fraud and deal with the culprits accordingly. In addition to direct investigation work, the Investigations Team also coordinates the City Council's participation in the National Fraud Initiative (NFI), which is a nationwide data-matching exercise.

10.6. As well as the Investigations Team, the Council's Trading Standards service conducts investigations into various aspects of business malpractice, such as counterfeit goods and sales of licenced merchandise to under age children. Though not aimed at fraud against the Council, its activities are an important part of the

Council's response to fraudulent activity within the City. The service's work is included in the annual counter-fraud reporting to the Audit and Risk Committee.

10.7. Finally, the Council has had a whistle-blowing policy for a number of years, to allow members of staff to report concerns or allegations of fraud and other malpractice in confidence. Following a number of high-profile referrals, which led to significant investigations, the policy became part of a wider Disclosure Policy which was brought to the Audit and Risk Committee for consideration and approval at its meeting on 3 December 2014.

## **11. Review of the Effectiveness of the Audit and Risk Committee**

11.1. In its publication *Audit Committees - Practical Guidance for Local Authorities*, CIPFA provided a self-assessment checklist to assist Councils in reviewing the effectiveness of their Audit Committees.

11.2. Using this checklist, it is considered that the Audit and Risk Committee meets all the requirements for an effective Audit Committee.

11.3. In summary:

- The Committee meets regularly and its chairmanship and membership are sufficiently independent of other functions in the Council. Meetings are conducted constructively, are free and open and are not subject to political influences;
- The Committee's terms of reference, which were formally revised and approved during the year, provide a sufficient spread of responsibilities covering internal and external audit, risk management and governance;
- The Committee plays a sufficient role in the management of Internal Audit, including approval of the audit plan, review of Internal Audit's performance and the outcomes of audit work and management's response to that; and,
- The Committee receives reports from KPMG as the Council's external auditor and maintains an overview of the external audit process including the fees charged.

However,

- It is acknowledged that Committee members need suitable training. Arrangements have been made to provide training on a relevant topic at the beginning of every meeting of the Committee. The Committee is subject, of course, to the risk of turnover of membership each municipal year, which is an inevitable consequence of the political environment in a local authority. When this happens the Head of Internal Audit and Risk Management provides 121 training for all new members.

**12. Conclusion**

12.1. Drawing all of the above together, it is concluded that Leicester City Council has a sufficiently effective system of internal audit for the Council to be able to place reliance on its assessment of the system of internal control.